

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Illinois Commerce Commission)	
on its own Motion)	
)	
Initiating proposed rulemaking relating to the)	Docket 17-0855
regulatory accounting treatment of cloud-)	
based solutions.)	
)	

**VERIFIED JOINT REPLY COMMENTS OF
AQUA ILLINOIS, INC. AND ILLINOIS-AMERICAN WATER COMPANY**

Dated: April 9, 2018

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I. Introduction

The Commission has concluded that “[t]here must be a level playing field between on-premise and cloud computing systems, especially because these systems serve the same functions.” *Ill. Commerce Comm’n on Its Own Mtn.*, Docket 17-0855, Initiating Order at 1 (Dec. 6, 2017). The Commission, therefore, ordered that this rulemaking “level the playing field between on-premise and cloud-based computing systems by clarifying the accounting rules to provide comparable accounting treatment of on-premise and cloud-based computing systems.” *Id.* As Aqua Illinois, Inc. and Illinois-American Water Company explained with other regulated Illinois utilities in initial comments, that directive must inform this rulemaking.

Accordingly, in assessing other parties’ initial comments on and proposed edits to Staff’s Proposed Part 289, Aqua and IAWC have used the rulemaking’s objective as their guide. If a proposal levels the playing field between on-premise and cloud-based computing systems from a regulatory accounting perspective and thus aligns with the rulemaking’s objective, Aqua and IAWC support it. If a proposal does not put the technologies on par and thus does not align with the rulemaking’s objective—or Illinois law—Aqua and IAWC oppose it.

Commonwealth Edison Company and the Advanced Energy Economy Institute propose limited edits to Staff’s Proposed Part 289 that are expressly grounded in the rulemaking’s objective. Their edits would enhance Part 289 by better promoting a level playing field between on-premise and cloud-based computing systems—in a manner that benefits both customers and utilities. Aqua and IAWC, therefore, support ComEd’s and AEEI’s edits. The Commission should adopt them.

The Citizens Utility Board acknowledges the importance of this rulemaking and supports the Commission’s directive. But, puzzlingly, CUB proposes two edits to Staff’s Proposed Part 289 that are contrary to not only the rulemaking’s objective, but also Illinois law: a requirement that

utilities demonstrate that their cloud-based (but not on-premise) investments are “cost-effective” (rather than “prudent and reasonable”); and a requirement that utilities’ cloud-based (but not on-premise) investments be “fully paid” (rather than “incurred”). Plainly, CUB’s edits require something more and something different for cloud-based investments than regulatory accounting rules and Illinois law require for on-premise investments. So, CUB’s edits don’t belong in the final Part 289. The Commission should reject them.

The Attorney General does not propose any edits to Staff’s Proposed Part 289. Instead, as the AG (alone) did during the Notice of Inquiry process that culminated in this rulemaking, the AG disputes the rulemaking’s objective altogether. The AG asks the Commission to “decline to adopt rules to provide anomalous treatment for cloud based computing services” and to “apply existing accounting rule [sic] to all utility expenses.” AG Init. Cmts. at 11. That is, the AG wants the Commission to decline to do what the Commission has already ordered should be done. The AG’s position, therefore, is moot. And although Aqua and IAWC respectfully question whether rulemaking parties’ resources are best expended responding to moot positions, to ensure a complete record, Aqua and IAWC explain below why the Commission should (again) reject the AG’s position. The AG’s position reflects so fundamental a misunderstanding of cloud-based computing systems costs, the related regulatory accounting effects, and the purpose of this rulemaking that the AG advocates a result adverse to both Illinois utility customers and Illinois utilities’ best interests. The Commission may disregard the AG’s initial comments entirely.

II. ComEd’s edits align with the rulemaking’s objective. Aqua and IAWC, therefore, support them.

A. ComEd incorporates a reasonable limitation in Section 289.40(b)(4)(ii).

Aqua and IAWC explained in initial comments that a reasonable limitation on the reporting requirement in Section 289.40(b)(4)(ii) would accord with the rulemaking’s objective because it

would recognize, as the Notice of Inquiry process concluded, that cloud-based computing is becoming the norm. Utils. Init. Cmts. at 7, 10; Initiating Order, Attach. (Apr. 7, 2017 *Notice of Inquiry Re the Regulatory Treatment of Cloud-Based Solutions, Report to the Comm’n (NOI Report)*) at 110, 124. ComEd would incorporate a \$5 million reporting threshold, for all utilities, in that subsection. ComEd Init. Cmts. at 2-3. ComEd’s proposal is not only reasonable in amount, for the reasons explained by ComEd, but also uniformly applicable to all utilities, including combined water and sewer utilities like Aqua and IAWC. Aqua and IAWC, therefore, support ComEd’s edit to Section 289.40(b)(4)(ii).

B. ComEd agrees that Section 289.40(b)(4)(iv) is problematic and must go.

Section 289.40(b)(4)(iv) would require utilities to provide with a rate case direct filing, for every cloud-based computing regulatory asset, a “business case analysis” that demonstrates that the utility has “fully considered” whether the cloud-based technology “is cost-effective and/or provides benefits and efficiencies to both the utility and its customers” relative to a “similar” on-premise technology. Staff Proposed Part 289 at 7. Aqua and IAWC explained in initial comments why that subsection is fatally flawed: it is ambiguous, unnecessary, impractical, and contrary to Illinois law. Utils. Init. Cmts. at 4-5. It treats cloud-based and on-premise investments disparately, in every respect and, consequently, misaligns with the rulemaking’s objective. *Id.* at 6. ComEd agrees. *See* ComEd Init. Cmts. at 4-7. So, ComEd, like Aqua and IAWC, advocates wholesale deletion of Section 289.40(b)(4)(iv). *Id.* at 7. Aqua and IAWC support that deletion.

III. AEEI’s edits align with the rulemaking’s objective. Aqua and IAWC, therefore, support those edits as well.

A. As edited, Section 289.10 expressly accords Part 289 with the Initiating Order.

Section 289.10 establishes the purpose of the rule. *See* Staff Proposed Part 289 at 2. AEEI would edit that section to expressly recognize, as the Commission did in its Initiating Order, the

rulemaking's objective to "level the playing field" between on-premise and cloud-based computing solutions. AEEI Init. Cmts. at 7; Initiating Order at 1. Mirroring the Initiating Order's language enhances Part 289 by ensuring alignment between the final rule and the Commission's rulemaking's objective. Thus, Aqua and IAWC support AEEI's edit to Section 289.10.

B. AEEI's edit to Section 289.40(c)(2) is better for customers and utilities.

Section 289.40(c) of Staff's Proposed Part 289 outlines the parameters for amortization of a regulatory asset under the rule. *See* Staff Proposed Part 289 at 7. AEEI proposes limited edits to that subsection to permit an amortization period for an annual cloud-based computing cost that is consistent with, rather than that ends at, the term of the associated cloud-based computing service contract. AEEI Init. Cmts. at 12 (revising Section 289.40(c)(2)). Aqua and IAWC understand those edits, as AEEI explains them using demonstrative schedules, to promote more flexible amortization periods relative to the amortization parameters of Staff's Proposed Part 289. *Id.* at 10-11.

The flexibility that AEEI proposes is better for customers. It will smooth the revenue requirement effect of regulatory assets under Part 289 relative to Staff's proposal. AEEI's schedules, as Aqua and IAWC understand them, demonstrate amortization of an example of a cloud-based computing solution regulatory asset under Staff's proposal and AEEI's proposal and of an on-premise computing solution of comparable cost. *See* AEEI Init. Cmts., Attach. A-B. Using those schedules, Aqua and IAWC have determined, and added, the revenue requirement effect of each scenario. *See* Attach. at 1-2. As shown on the attached schedule, under Staff's proposal, there would be a significant spike in the revenue required to be recovered through customer rates in later amortization years, because the revenue required for the regulatory asset under Staff's proposal would double year over year, starting at approximately \$1 million in year one, and ending at approximately \$11 million in year five. *Id.* If year five is a rate case test year, the result would be

a spike in customer rates. If, however, year five is not a rate case test year, the utility would be required to manage that spike in expenses. AEEI's proposed, more flexible amortization proposal removes that spike. It smooths the revenue requirement impact over the course of the amortization period—to the benefit of utilities and customers alike. *Id.* AEEI's proposal, therefore, is preferable to Staff's.

AEEI explains that its proposal also would allow utilities the opportunity, not available under Staff's Proposed Part 289, to earn the same return for investors on their cloud-based investments as on their on-premise investments of the same cost. The edits, at the same time, would not require utilities to either prepay cloud-based computing costs or allow them to record as a regulatory asset cloud-based computing costs not yet incurred. AEEI Init. Cmts. at 12.

Thus, AEEI's edits appear to be a reasonable attempt to balance competing customer and utility interests, and they better and more fairly align Part 289 with the Commission's rulemaking objective to level the playing field between cloud-based and on-premise technologies. Accordingly, Aqua and IAWC support AEEI's edits to Section 289.40(c)(2), but also propose limited additional clarifying edits, over AEEI's edits:

Each payment recorded as a Regulatory Asset ~~recorded~~ under this Part ~~shall~~ may be amortized over a period ~~that begins~~ beginning with no earlier than the in-service date and ~~ending at the conclusion~~ that is the same length of time as the duration of the Service Contract Term with which the Regulatory Asset is associated. The Regulatory Asset's unamortized balance shall be included in rate base, subject to Section 289.40(a).

These additional edits will not only clarify how the more flexible amortization under Part 289 will work, but also better align Section 289.40(c) with Section 289.40(a)'s provision that “[a] Public Utility may record as a Regulatory Asset and, subject to the Commission’s determination of prudence and reasonableness in a rate case, include in rate base, those costs associated with Cloud-

based Computing Solutions” Staff Proposed Part 289 at 6. The Commission, therefore, should adopt these and AEEI’s edits to Section 289.40(c)(2).

IV. CUB’s edits contravene not only the rulemaking’s objective, but also Illinois law. The Commission should reject them.

CUB’s initial comments on Staff’s Proposed Part 289 are puzzling. CUB recognizes the many benefits of cloud-based technologies and reminds that it “should not be ignored . . . that technology is rapidly evolving while the utility industry is prevented in some way from evolving technologically[] due to the regulatory treatment of computing solutions.” CUB Init. Cmts. at 2-3. And CUB “is encouraged that the proposed creation of Part 289 will bring the benefits realized by utilities to customers as well, by simultaneously lowering costs passed along to ratepayers for computing solutions, improving safety, increasing reliability, and strengthening security.” *Id.* at 3. CUB, therefore, concludes that it doesn’t object to the rulemaking—but only if the rule includes “a requirement that the utility demonstrate that the cloud-based computing solution is cost-effective.” *Id.*

CUB would also require that a utility’s cloud-based investments be “fully paid” before the utility can benefit from the rule. *Id.* at 5-6, Attach. A at 7 (editing Section 289.40(b)(4)(iv)).

Both CUB’s “cost-effective” and “fully paid” edits are inconsistent with the rulemaking’s objective to put cloud-based and on-premises technologies on par from a regulatory accounting perspective. And neither accord with Illinois law. The Commission, therefore, should reject them.

A. CUB’s “cost-effective” edit is fatally flawed.

CUB’s “cost-effective” edit would revise Section 289.40(b)(4)(iv) of Staff’s Proposed Part 289 to require a utility, with every rate case direct filing, for every cloud-based computing regulatory asset, to provide “a comprehensive cost-benefit analysis which demonstrates that (1) the Cloud-based Computing Solution is cost-effective and (2) provides benefits and efficiencies to

both the utility and its customers compared to a similar On-premises Computing Solution.” CUB Init. Cmts. at 3-4, Attach. A at 7 (editing Section 289.40(b)(4)(iv)).

CUB’s edit is similar to Staff’s originally-proposed “cost-effective” requirement in Section 289.40(b)(4)(iv). *See* Staff Proposed Part 289 at 7. It suffers, therefore, from the same flaws as that section: it is ambiguous, unnecessary, impractical, and contrary to Illinois law. *See* Utils. Init. Cmts. at 4-6. But CUB’s “cost-effective” edit doubles-down, requiring a utility to *affirmatively demonstrate*, rather than to have considered, that its cloud-based investments are “cost-effective,” and to make that demonstration not just in rate cases for the first five years of Part 289’s effectiveness, but *for all time*. CUB Init. Cmts., Attach A at 7. There are additional problems, therefore, with CUB’s “cost effective” edit and CUB’s arguments in support of that edit.

1. The edit flouts the rulemaking’s objective.

a. There aren’t similar requirements for on-premise investments.

As Aqua and IAWC explained in initial comments, there are no comparable “cost-benefit analysis” or “cost-effective” requirements for on-premise investments. Utils. Init. Cmts. at 6. (With good reason. As explained, “prudence and reasonableness” is the correct legal standard. *Id.* at 6; *see also supra* IV.A.2.a.) CUB concedes this. CUB complains that in “CUB’s experience” in rate cases, “the review of computing systems and their accompanying costs are [sic] somewhat of a ‘black box’ of expenses that cannot be meaningfully examined.” CUB Init. Cmts. at 4. That is, CUB proposes a “cost-effective” requirement for cloud-based investments that it perceives as lacking for on-premise investments. Requiring something *more* for cloud-based investments, however, directly contravenes the rulemaking’s objective to treat the technologies comparably.

b. The edit is unrelated to regulatory accounting.

CUB’s “cost-effective” edit isn’t about developing comparable regulatory accounting for on-premise and cloud-based computing solutions. In fact, it’s not about regulatory accounting at

all. Accordingly, it exceeds the parameters of this rulemaking to “level the playing field between on-premise and cloud-based computing systems by clarifying the accounting rules to provide comparable accounting treatment of on-premise and cloud-based computing systems.” Initiating Order at 1. The Commission may reject CUB’s “cost-effective” edit on that basis alone.

Still, CUB tries to conceive a connection between the rulemaking’s objective and the edit by claiming that the edit “would ensure that the deviation from current financial standards . . . do not provide for unjust enrichment of the utilities that choose to utilize the accounting treatment provided for under Part 289.” CUB Init. Cmts. at 4. CUB’s attempt fails, in two ways.

First, it (mis)assumes that utilities will opt for cloud-based *over* on-premise technologies because of Part 289. That, assumption, however, ignores that the Commission intends utilities to be “technology agnostic.” *NOI Report* at 124. The purpose of the rulemaking is not to *elevate* cloud-based over on-premise computing solutions, but to put the technologies *on par*.

Second, it (mis)assumes that the regulatory accounting for cloud-based investments under Staff’s Proposed Part 289 is *preferable* to the regulatory accounting for on-premise investments. It’s not. As AEEI explains, the return that a utility’s investors may earn on a cloud-based investment under Staff’s Proposed Part 289, as drafted, is *half* the return that those investors may earn for an on-premise investment of comparable cost. *See* AEEI Init. Cmts. at 8-10, Attach. A. Given the earnings disparity and the myriad benefits of cloud-based investments, which CUB acknowledges, it is unreasonable to assume that a utility will pursue a cloud-based investment over an on-premise investment for the sole purpose of “unjust enrichment.”

c. The purpose of the edit—CUB admits—is to circumvent rate case discovery.

CUB admits that its “cost effective” requirement is clearly beyond the parameters of this rulemaking. Again, CUB complains that in “CUB’s experience[,] . . . the review of computing

systems and their accompanying costs are somewhat of a ‘black box’ of expenses that often cannot be meaningfully examined in the course of those proceedings.” CUB Init. Cmts. at 4. In other words, CUB is dissatisfied with the software cost data that has been disclosed in utility rate cases. So, CUB—expressly—wants to use this rulemaking to require utilities to provide that data up front, at least for cloud-based software.

It is improper for CUB to attempt to use Part 289 to circumvent its rate case discovery obligation. That attempt flouts not only the rulemaking’s regulatory accounting purpose, as explained, but also the Commission’s discovery rules. Just last year, the Commission “remind[ed]” CUB and other rate case “parties that the discovery process is available to them” *Ameren Ill. Co.*, Docket 17-0197, Order at 26 (Dec. 6, 2017). The discovery rules provide CUB the tools to solicit data to assess the prudence and reasonableness of utility costs, cloud-based computing systems costs included. Part 289 is not the appropriate vehicle.

2. The edit is at odds with Illinois law.

a. Prudence and reasonableness, not cost-effectiveness, is the correct legal standard.

Aqua and IAWC explained in initial comments that the legal standard for rate recovery of utility costs is “prudent and reasonable.” Util. Init. Cmts. at 5 (citing 220 ILCS 5/1-102(a)(iv); *Citizens Util. Bd. v. Ill. Commerce Comm’n*, 166 Ill. 2d 111, 121 (1995)). CUB’s edit, however, would require a utility to demonstrate that its cloud-based investments (but not its on-premise investments) are “cost-effective.” CUB Init. Cmts. at 2, Attach. A at 7. So, CUB’s “cost-effective” edit imposes the wrong legal standard. It requires something *different* for cloud-based investments.

CUB’s initial comments acknowledge this. CUB concedes “that simply demonstrating that an investment is cost-effective does not, on its own, demonstrate the reasonableness and prudence

of that investment. The regulation would not, and cannot, supersede the statutory requirement contained in Section 9-201(c) regarding just and reasonable rates.” *Id.* at 4.

What purpose, then, would CUB’s “cost-effective” requirement serve? CUB tells us. CUB believes that “cost effective” is a “standard” that would ensure that cloud-based investments are “reasonable and just.” *Id.* This, however, is an argument for rate cases. If CUB believes that “cost-effectiveness” (however CUB defines that term) is evidence of prudence and reasonableness, CUB may make its case in a rate case. But, the evidence that the Commission ultimately deems sufficient to support a finding of prudence and reasonableness in a rate case is up to the Commission. There is no general prescription on the form that that evidence must take.

Nor would it be fair to prescribe—in Part 289 or otherwise—that evidence as CUB suggests. Again, CUB’s “cost-effective” edit would require a utility, with every rate case direct filing, for every cloud-based computing regulatory asset, to provide “a comprehensive cost-benefit analysis which demonstrates that (1) the Cloud-based Computing Solution is cost-effective and (2) provides benefits and efficiencies to both the utility and its customers compared to a similar On-premises Computing Solution.” CUB Init. Cmts. at 3-4, Attach. A at 7. CUB, however, never defines what it means by “a *comprehensive* cost-benefit analysis” or “cost-effective” or even a “similar” on-premise investment. And, because those terms don’t reflect the correct legal standard, they are otherwise vague. This renders entirely unworkable CUB’s already impermissible attempt to prescribe and require the evidence that—CUB thinks—would support the prudence and reasonableness of cloud-based computing systems costs.

b. The edit would impermissibly shift rate case intervenors’ legal burden of proof.

CUB summarily states that “the inclusion of a cost-effective requirement” in Part 289 won’t change utilities’ “rate case legal burden of proof to establish that proposed rates are just and

reasonable.” CUB Init. Cmts. at 4-5. But CUB omits that rate case intervenors *also* bear a legal burden of proof, which CUB’s “cost-effective” edit impermissibly shifts to utilities.

The Commission recently explained rate case parties’ burdens of proof in Docket 16-0262, Ameren Illinois Company’s annual electric formula rate update case:

The Commission finds that it first must address the legal burdens borne by utilities and other parties in utility rate cases. IIEC/CUB take the position that EIMA places the burden to support the prudence and reasonableness of the costs of utility service ‘squarely on the utilities,’ while Ameren contends that once a utility demonstrates the costs necessary to provide service under its proposed rates, it has made a *prima facie* case, the burden then shifts to the party attempting to show that the costs incurred by the utility are unreasonable or should otherwise not be recovered in rates. The EIMA requires the Commission to apply the same evidentiary standards, including burdens of proof, as the Commission would apply in an Article IX rate case. 220 ILCS 5/16-108.5(d). The Commission reasons that under Article IX and Illinois common law, the position espoused by Ameren is correct. This position was also adopted in *Apple Canyon Lake Prop. Owners’ Ass’n v. Ill. Commerce Commission*, 2013 IL App (3d) and *Ill. Bell Telephone Co. v. Ill. Commerce Commission*, 327 Ill. App. 3d 768, 776 (3d Dist. 2008).

Ameren Ill. Co., Docket 16-0262, Order at 16 (Dec. 6, 2016).

Simply put, a utility need not come forward in its case in chief with evidence that anticipates opponents’ objections. *Peoples Gas Light & Coke Co. v. Slattery*, 373 Ill. 31, 61-62 (1939). *See also Chicago v. Ill. Commerce Comm’n*, 133 Ill. App. 3d 435, 442–43 (1st Dist. 1985) (dismissing “the erroneous assumption that a utility has the burden of going forward on any and all issues which are conceivably relevant to the reasonableness of its proposed rates.”). Rather, once a utility establishes that its rates are necessary to provide service, it has made a *prima facie* case, and “the burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith.” *Chicago*, 133 Ill. App. 3d at 442–43; Docket 16-0262, Order at 16 (“The Commission holds that Ameren’s compliance with the requirements of statutory and [Part 285] administrative rules concerning filings constitutes a *prima facie* case.”).

Utilities, therefore, are not required to demonstrate with a rate case direct filing that every management decision—for example, to install a 12-inch rather than an 8-inch main—was “cost-effective” (however CUB defines that term), as CUB would require for all cloud-based investments, forever. The law instead requires utilities to provide the myriad cost data in support of their proposed rates mandated by Part 285. And upon that showing, the utility’s burden of proof shifts to other rate case parties to conduct discovery, assess the prudence and reasonableness of the utility’s costs, and, if they deem appropriate, propose cost adjustments. *Id.* CUB’s “cost-effective” edit would unlawfully remove that shift, by requiring utilities to provide something *more* in their case in chief for cloud-based computing systems costs.

3. Staff’s Proposed Part 289 already alleviates (what should be) CUB’s concern regarding cloud-based computing investments.

If CUB’s ultimate concern is that utilities should be permitted to use Part 289—and rate base cloud-based computing costs as regulatory assets—only when the costs are prudent and reasonable, Staff’s Proposed Part 289 already resolves that concern. It allows a utility to include a cloud-based regulatory asset in its rate base only “subject to the Commission’s determination of prudence and reasonableness in a rate case.” Staff Proposed Part 289 at 6 (Section 289.40(a)).

B. CUB’s “fully paid” edit invites unnecessary and irreconcilable confusion.

CUB proposes one other edit to Staff’s Proposed Part 289. CUB argues that it “believes . . . that costs must be *paid* in order to be recorded as a regulatory asset.” CUB Init. Cmts. at 5 (emphasis added). CUB also argues that “[c]osts that are not *prepaid* cannot be included in rate base . . .,” referring to “an upfront, *prepaid* investment in the computing solution.” *Id.* at 6 (emphasis added). Ultimately, CUB proposes that Section 289.40(b)(1) be edited to require that cloud-based computing costs be “*fully paid*”—rather than “incurred”—before they may be

recorded as a regulatory asset under Part 289. *Id.*, Attach. A at 6 (revising Section 289.40(b)(1)) (emphasis added).

It's unclear whether CUB is advocating for an actual outlay of cash before a cloud-based computing cost can be recorded to a regulatory asset, or for prepayment of cloud-based computing service contracts. That uncertainty alone renders CUB's edit vague and, consequently, unworkable. Regardless, either way, CUB's position fatally flawed. If CUB's position is the former (an outlay of cash), it contravenes Illinois law. If it's the latter (prepayment), it contravenes the rulemaking's objective.

1. If the edit means that utilities must first outlay cash before recording a cloud based regulatory asset, it violates the Commission's rules.

a. The test year rules permit rate recovery of forecasted costs.

The Commission's test year rules permit a utility to base proposed rates on a 12-month period of forecasted revenues and expenses. 83 Ill. Adm. Code 287.20(b). CUB's requirement that cloud-based costs be "fully paid," however, would preclude a utility from including forecasted cloud-based computing costs—which, necessarily cannot be "fully paid"—in its rate case test year. CUB's edit, therefore, would create an irreconcilable conflict between Parts 287 and 289.

b. The Uniform System of Accounts for Water Utilities authorizes accrual basis accounting.

Accrual basis accounting matches expenses with related revenues and thus recognizes an expense when it occurs or is "incurred"—when the utility receives the service and therefore becomes liable for it. Cash basis accounting recognizes expenses when the cash is paid.

The Commission has adopted the Uniform System of Accounts for Water Utilities. *See* 83 Ill. Adm. Code 605.10. The USOA authorizes Aqua and IAWC to use accrual basis accounting:

Operating Income - Accrual Accounting

Monthly accounting using the accrual method is required. During the accounting period, certain amounts may have been earned although collection is not to be made until the subsequent period, *and certain expenses may have been incurred, although payment is not to be made until a subsequent period.* At the end of the accounting period the revenues and expenses shall be recognized by charging the appropriate revenue or expense account and corresponding receivable or liability account.

Nat'l Assoc. of Reg. Util. Comm'rs, *Uniform System of Accounts for Class A Water Utils.*, Instr. 36 (1996) (emphasis added).

Consistent with Part 605 and accrual basis accounting, Section 289.40(b)(1) of Staff's Proposed Part 289 appropriately recognizes cloud-based computing costs that are "incurred." Staff Proposed Part 289 at 6. CUB's "fully paid" edit, in requiring cash basis accounting, would create yet another irreconcilable conflict between two Commission's rules—this time Parts 605 and 289.

2. If the edit means that utilities must first prepay cloud-based investment costs, it ignores the rulemaking's objective.

a. Requiring prepayment would moot the flexibility benefit of cloud-based computing solutions.

As CUB recognizes, cloud-based computing solutions may "provide accelerated delivery of solutions" and "more flexible . . . computing infrastructure." CUB Init. Cmts. at 3 (citing *NOI Report*). AEEI further explains the flexibility benefit of cloud-based computing solutions:

One of the primary reasons that other industries have quickly adopted cloud computing is that it provides capacity on demand. Users of cloud computing services—unlike on-premise IT systems and other CapEx—do not need to forecast their usage in advance or commit to payments for service levels that they may not use. This provides both operational flexibility and potential for cost savings that may not be possible in a pre-paid service arrangement.

AEEI Init. Cmts. at 5.

CUB acknowledges that this flexibility, among other benefits of cloud-based computing, is an impetus for this rulemaking—the Commission intends to remove the regulatory accounting disincentives to utilities to pursue beneficial cloud-based computing solutions. CUB Init. Cmts. at

2-3. Nevertheless, CUB wants to require utilities to prepay a cloud-based computing service contract's cost. CUB's initial comments are internally inconsistent on this point. Prepayment would negate "the rapid elasticity inherent in cloud-based solutions [that] allow capacity to be upgraded regularly to match requirements." *NOI Report* at 112. *See also* AEEI Init. Cmts. at 5. That is, CUB's "fully paid" edit would moot the flexibility benefit of cloud-based computing solutions that CUB touts. That renders the edit inconsistent with the rulemaking's objective.

b. Requiring prepayment would permit use of Part 289 in only rare circumstances.

Aqua and IAWC, like other Illinois regulated utilities, operate within a parent company holding structure. IT services are typically provided by a services company affiliate and shared among several affiliates, to realize economies of scale. That means that software investment costs are often incurred at the services company level and allocated among affiliates.

CUB's "fully paid" edit ignores this structure. It would require regulated utilities' services companies to prepay the potentially significant cost of a cloud-based computing solution that benefits multiple affiliates for the Illinois regulated utility affiliate to use Part 289.

Moreover, prepayment may not always be an option to the utility. Certain cloud-based software vendors don't allow prepayment, instead requiring only annual billing and payment. Certain other cloud-based vendors require an initial contract term, for example three years. They then require contract renewals annually thereafter, when annual payments are made. In these circumstances where prepayment is either not available or not optimal, CUB's "fully paid" edit would preclude the utility from using Part 289. This, again, would negate the usefulness of the rule and, in turn, the intended benefits of a level playing field between cloud-based and on-premise investments.

V. The AG disregards the rulemaking’s objective altogether, so the Commission may disregard the AG’s initial comments altogether.

A. The AG’s initial comments are stale and moot.

The AG doesn’t propose any edits to Staff’s Proposed Part 289. Instead, the AG asks the Commission to “decline to adopt rules to provide anomalous treatment for cloud based computing services.” AG Init. Cmts. at 11. But the Commission has already found that “[t]here must be a level playing field between on-premise and cloud computing systems, especially because these systems serve the same functions.” Initiating Order at 1. It has already directed this rulemaking and initiated this docket towards that end. *Id.* at 1-2. And the ALJ, Staff, and myriad parties have already expended substantial resources to comply with the Commission’s order. So, the AG’s position in initial comments is moot.

The AG admits that the AG’s position is also stale, in that the AG already “took clear exception to the premise that current accounting rules need to be modified to stimulate utility investment in cloud computing” in the Notice of Inquiry process. AG Init. Cmts. at 2. Notice of Inquiry participants responded to that position and the process’s conclusions—and, ultimately, the Commission in its Initiating Order—disagreed with it. *See, e.g., NOI Report* at 122.

B. The AG fundamentally misunderstands why we’re here.

Respectfully, neither the rulemaking parties nor the Commission should have to respond (again) to stale, moot positions. Nevertheless, in the interest of a complete record, Aqua and IAWC will explain why the AG’s position is premised on misunderstandings of cloud-based computing systems costs, the related regulatory accounting effects, and the purpose of this rulemaking that are so fundamental that the AG advocates a result adverse to Illinois utility customers.

1. The AG misunderstands cloud-based computing systems costs.

As the *NOI Report* explains, there are several types of costs associated with cloud-based computing solutions: generally, significant upfront costs, like data migration costs, and ongoing, often annual, service contract costs. *NOI Report* at 113-14. Throughout initial comments, the AG refers selectively to the latter, *see, e.g.*, AG Init. Cmts. at 2, 5, 6, 10, and ignores the former. This is important. While cloud-based computing solutions may have a lower overall cost, as with on-premise solutions, the upfront costs may be substantial—millions of dollars.

2. The AG misunderstands the related regulatory accounting effects.

The AG prefers to expense, rather than capitalize, these substantial upfront costs. There are problems with this regulatory accounting, which is adverse to both utilities and customers.

If the expenses are incurred in a rate case test year, they may be recovered from customers in rates—dollar for dollar. This may materially increase the rates that utility customers pay.

If, however, the expenses are not incurred in a rate case test year, the costs, which could be substantial, are not rate recoverable. Utilities, therefore, would be discouraged from investing in cloud-based solutions that are otherwise advantageous to both customers and utilities.

That cloud-based technology is becoming the norm, *see* Utils. Init. Cmts. at 2, compounds these problems for utilities and their customers.

The AG argues that existing accounting rules solve these problems. First, the AG argues that “the Commission should recognize that existing accounting rules already address [cloud-based computing costs], and in fact have been updated to clarify how off-site systems and software should be accounted for.” AG Init. Cmts. at 7 (citing FASB ASU 2015-05). But FASB ASU 2015-05 permits capital treatment of cloud-based solutions costs in only the rarest circumstances, typically not available to regulated utilities. *See NOI Report at 110-11*. The Commission is well aware of FASB ASU 2015-05, in any event. The Commission has directed this rulemaking in part

because that accounting guidance not only doesn't solve the problems with expensing cloud-based solutions costs, but also isn't clear: "utilities should have clear guidance regarding how to characterize a cloud-based system. The current accounting treatment, and its lack of clear guidance, may discourage Illinois utilities from deploying cloud based solutions provided by third party vendors. The FASB Accounting Standards Update 2015-05 was enacted in April 2015, and its effects are still largely unknown." *Id.* at 121-22.

The AG also argues that the Commission may treat "initial or portions of cloud-computing costs . . . as a regulatory asset." AG Init. Cmts. at 2, 4. Aqua and IAWC agree. And that is an intended result of this rulemaking—to exercise the Commission's regulatory asset authority when it comes to cloud-based solutions in a manner that is fair and consistent for all utilities. The AG champions "consistent regulatory treatment," *id.* at 11, and this rulemaking will ensure it.

3. The AG otherwise misunderstands the purpose of this rulemaking.

The AG suggests that the purpose of this rulemaking is to favor cloud-based computing services and service vendors with "advantageous accounting options unavailable to other service vendors." AG Init. Cmts. at 8. As explained, however, the rulemaking's express objective is not to incentivize utilities to select one form of technology over the other, but to make utilities "technology agnostic." *NOI Report* at 124.

Section 289.40(a) of Staff's Proposed Part 289 clearly reflects this objective. It provides regulatory asset treatment for only

those costs associated with Cloud-based Computing Solutions that would be recorded to a utility plant account in accordance with Financial Accounting requirements if the costs were for an On-premise Computing Solution, rather than a Cloud-based Computing Solution All other costs associated with Cloud-based Computing Solutions shall be recorded in accordance with Financial Accounting requirements, Commission practice, rules, and law.

Staff Proposed Part 289 at 6. In other words, the rule provides the *same* treatment for cloud-based investments as is already available for on-premise investments. Nothing different.

Plainly, despite the AG's misunderstanding, Part 289 affords no special treatment for cloud-based computing systems or service vendors relative to on-premise computing systems or service vendors.

VI. Conclusion

The Commission has concluded that “[t]here must be a level playing field between on-premise and cloud computing systems, especially because these systems serve the same functions.” Initiating Order at 1. The Utilities’—including Aqua and IAWC’s—ComEd’s, and AEEI’s edits to Staff’s Proposed Part 289 further that objective. CUB’s edits contravene it (and Illinois law), and the AG’s position outright defies it. The Commission, therefore, should adopt the Utilities’, ComEd’s, and AEEI’s edits. And it should reject, wholesale, CUB’s flawed edits and the AG’s stale, moot position. Then, this rulemaking can accomplish its objective to level the regulatory accounting playing field between on-premise and cloud computing systems, ensuring that regulated utilities are technology agnostic.

Dated: April 9, 2018

Respectfully submitted,

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	Capitalization Percentage	Cost	Weighted Cost	WACC Post -Tax Weighted Cost
Common Equity	45.00%	8.50%	3.83%	3.83%
Preferred Stock	0.00%	0.00%	0.00%	0.00%
Long Term Debt	55.00%	5.00%	2.75%	2.75%
Short Term Debt	0.00%	0.00%	0.00%	0.00%
Total	100%			6.58%

Staff Rule

Service Contract Years 5
Service Contract Annual Cost \$5,000,000

Year	Annual Payment	Total Cumulative Payment	Amortization	Accumulated Amortization	Unamortized Cumulative Balance	Utility Carrying Costs			Debt Payments	Cash Flows	Revenue Requirement (WACC - post tax)
						Debt	Equity	Total			
1	\$5,000,000	\$5,000,000	\$1,000,000	\$1,000,000	\$4,000,000	\$110,000	\$153,000	\$263,000	\$110,000	(\$3,847,000)	\$1,263,000
2	5,000,000	10,000,000	2,250,000	3,250,000	6,750,000	185,625	258,188	443,813	185,625	(2,491,813)	\$2,693,813
3	5,000,000	15,000,000	3,916,667	7,166,667	7,833,333	215,417	299,625	515,042	215,417	(783,708)	\$4,431,708
4	5,000,000	20,000,000	6,416,667	13,583,333	6,416,667	176,458	245,438	421,896	176,458	1,662,104	\$6,838,563
5	5,000,000	25,000,000	11,416,667	25,000,000	0	0	0	0	0	6,416,667	\$11,416,667
	\$25,000,000		\$25,000,000			\$687,500	\$956,250	\$1,643,750	\$687,500	\$956,250	Earnings

AEEI Alternative Amortization of Cloud Computing Costs

Service Contract Years 5
Service Contract Annual Cost \$5,000,000

Year	Annual Payment	Total Cumulative Payment	Amortization	Accumulated Amortization	Unamortized Cumulative Balance	Utility Carrying Costs			Debt Payments	Cash Flows	Revenue Requirement (WACC - post tax)
						Debt	Equity	Total			
1	\$5,000,000	\$5,000,000	\$1,000,000	\$1,000,000	\$4,000,000	\$110,000	\$153,000	\$263,000	\$110,000	(\$3,847,000)	\$1,263,000
2	5,000,000	10,000,000	2,000,000	3,000,000	7,000,000	192,500	267,750	460,250	192,500	(2,732,250)	\$2,460,250
3	5,000,000	15,000,000	3,000,000	6,000,000	9,000,000	247,500	344,250	591,750	247,500	(1,655,750)	\$3,591,750
4	5,000,000	20,000,000	4,000,000	10,000,000	10,000,000	275,000	382,500	657,500	275,000	(617,500)	\$4,657,500
5	5,000,000	25,000,000	5,000,000	15,000,000	10,000,000	275,000	382,500	657,500	275,000	382,500	\$5,657,500
6		25,000,000	4,000,000	19,000,000	6,000,000	165,000	229,500	394,500	165,000	4,229,500	\$4,394,500
7		25,000,000	3,000,000	22,000,000	3,000,000	82,500	114,750	197,250	82,500	3,114,750	\$3,197,250
8		25,000,000	2,000,000	24,000,000	1,000,000	27,500	38,250	65,750	27,500	2,038,250	\$2,065,750
9		25,000,000	1,000,000	25,000,000	0	0	0	0	0	1,000,000	\$1,000,000
	\$25,000,000		\$25,000,000			\$1,100,000	\$1,530,000	\$2,630,000	\$1,100,000	\$1,912,500	Earnings
			(Correction to Include all Years)			\$1,375,000	\$1,912,500	\$3,287,500	\$1,375,000	\$1,912,500	

AEEI Alternative Amortization of On-Premise Solution

Service Contract Years 5
Service Contract Annual Cost \$5,000,000

<u>Year</u>	<u>Upfront Cost</u>	<u>Total Cumulative Payment</u>	<u>Amortization</u>	<u>Accumulate d Amortization</u>	<u>Unamortized Cumulative Balance</u>	<u>Utility Carrying Costs</u>			<u>Debt Payments</u>	<u>Cash Flows</u>	<u>Revenue Requirement (WACC - post tax)</u>
						<u>Debt</u>	<u>Equity</u>	<u>Total</u>			
1	\$25,000,000	\$25,000,000	\$5,000,000	\$5,000,000	\$20,000,000	\$550,000	\$765,000	\$1,315,000	\$550,000	(\$19,235,000)	\$6,315,000
2		25,000,000	5,000,000	10,000,000	15,000,000	412,500	573,750	986,250	412,500	5,573,750	\$5,986,250
3		25,000,000	5,000,000	15,000,000	10,000,000	275,000	382,500	657,500	275,000	5,382,500	\$5,657,500
4		25,000,000	5,000,000	20,000,000	5,000,000	137,500	191,250	328,750	137,500	5,191,250	\$5,328,750
5		25,000,000	5,000,000	25,000,000	0	0	0	0	0	5,000,000	\$5,000,000
	\$25,000,000		\$25,000,000			\$1,375,000	\$1,912,500	\$3,287,500	\$1,375,000	\$1,912,500	Earnings

STATE OF ILLINOIS)
)
COUNTY OF KANKAKEE)

VERIFICATION


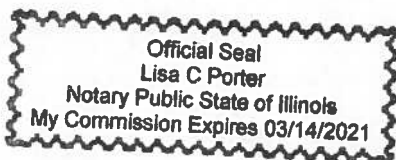
I, Paul Hanley, certify that: (i) I am Controller for Aqua Illinois, Inc.; (ii) I have read the attached *Verified Joint Reply Comments*; (iii) I am familiar with the facts stated therein; and (iv) the facts stated therein are true and correct to the best of my knowledge.



Paul Hanley
Controller
Aqua Illinois, Inc.

SUBSCRIBED AND SWORN to before

me this 9 day of April 2018.


Notary Public

STATE OF ILLINOIS)
)
COUNTY OF ROCK ISLAND)

VERIFICATION

I, Rich Kerckhove, certify that: (i) I am Director, Rates and Regulatory, for Illinois-American Water Company; (ii) I have read the attached *Verified Joint Reply Comments*; (iii) I am familiar with the facts stated therein; and (iv) the facts stated therein are true and correct to the best of my knowledge.



Rich Kerckhove
Director, Rates and Regulatory
Illinois-American Water Company

SUBSCRIBED AND SWORN to before

me this 9th day of April 2018.



Notary Public



CERTIFICATE OF SERVICE

I, Anne M. Zehr, an attorney, certify that on April 9, 2018, I caused a copy of the foregoing *Verified Joint Reply Comments* to be served by electronic mail to the individuals identified below, who appear on the Commission's Service List for Docket 17-0855 as of the date of this filing.

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